Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1979

No. 79-1533

W.R. GRACE & CO., INC., a corporation,

Petitioner,

vs.

E-T INDUSTRIES, INC. and PYRAMID ENTERPRISES,

Respondents.

W. R. GRACE & CO., INC., a corporation,

Petitoner,

vs.

WESTERN U.S. INDUSTRIES, INC., a corporation,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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WESTERN U.S. INDUSTRIES, INC., a corporation,
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Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner W.R. Grace & Co., Inc. ("Grace") prays that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Ninth Circuit in these consolidated cases.

Opinions Below.

The opinion of the Court of Appeals appears at 608 F.2d 1214 (9th Cir. 1979). The District Court's opinion is unofficially reported at 187 U.S.P.Q. 40 (C.D. Cal. 1975).

Jurisdiction.

The Ninth Circuit's judgment was entered on October 9, 1979. A timely petition for rehearing *en banc* was

denied by the Court of Appeals on December 26, 1979. This Court has jurisdiction to review the judgment below by writ of certiorari pursuant to 28 U.S.C. §1254(1).

Questions Presented.

This Petition presents an important question of law which has far-reaching ramifications for every corporation which seeks to obtain and enforce United States letters patent, namely:

> Can a corporation be deprived of its right to enforce a presumptively valid patent *as a matter of law* solely on the basis of an inaccurate statement to the Patent Office where
>
> (1) none of the corporation's agents or employees, including the official who made the statement, acted in bad faith or even with calculated recklessness; and
>
> (2) the information inadvertently omitted would not have automatically established the patent's invalidity?

The Ninth Circuit answered this question affirmatively by adopting a standard of strict corporate liability for innocent misstatements before the Patent Office. Under the Court of Appeals' ruling, so long as someone, somewhere in a corporation, possesses information which is mistakenly omitted from a document filed during the patent application process, that knowledge is imputed to the corporation; and the corporation itself, as a separate legal entity, is *ipso facto* guilty of inequitable conduct *as a matter of law*—even though none of the individuals, through which the corporation acts, is personally guilty of any misconduct. This holding—which would have drastic consequences for corporate patent owners in general—is in direct conflict with the rule in the majority of other Circuits that the

standard for inequitable conduct before the Patent Office "is not one of strict liability for innocent or even negligent omissions or misstatements," and that "to result in refusal to enforce a patent, the misconduct must be accompanied by 'some element of wrongfulness, willfulness or bad faith.'" *Pfizer, Inc. v. International Rectifier Corp.*, 538 F.2d 180, 186 (8th Cir. 1976), *cert. denied*, 429 U.S. 1040 (1977). We respectfully urge, therefore, that *certiorari* be granted to resolve this important question of law.

Statement of the Case.

This Petition arises out of two infringement suits brought by Grace to enforce a design patent on a custom automobile wheel—one against Western U.S. Industries, Inc. (the *Western* action) and the other against two related companies, E-T Industries, Inc. and Pyramid Enterprises, Inc. (the *E-T* action). In both actions, defendants alleged, *inter alia*, that Grace's patent was unenforceable because of inequitable conduct before the Patent Office.

While the cases were consolidated for trial purposes, they were tried—over Grace's objection—to different fact finders: the *E-T* action to the trial judge, and the *Western* action to the jury.[1] At the close of Grace's evidence, the trial judge entered judgment for defendants in the *E-T* action under Fed. R. Civ. P. 41(b), and directed a verdict for defendant in the *Western* action under Fed. R. Civ. P. 50(a). Both dismissals were grounded in part on the trial judge's finding that Grace was "guilty of unclean hands and/or fraud in

[1]Although Grace had demanded a jury trial in both cases, its demand in the *E-T* action came more than 10 days after the last pleading was filed. Accordingly, Grace moved for a jury trial of the *E-T* action under Fed. R. Civ. P. 39(b). The District Court, declining to exercise its discretion, denied Grace's motion.

[its] conduct before the Patent Office . . . ." *W.R. Grace & Co., Inc. v. Western U.S. Industries, Inc.*, 187 U.S.P.Q. 40, 44 (C.D. Cal. 1975).

One of the principal bases for this finding—and the only one addressed by the Court of Appeals on appeal—was the submission of an affidavit to the Patent Office by Floyd Merritt, president of Grace's custom wheel division. In support of Grace's claim that the commercial success of its patented design was due primarily to its inherent appeal and novelty, the Merritt affidavit stated:

> "Our *major* advertising so far has been a one-page ad in *Car Craft* [magazine], when we first offered the Wire Mag wheel, in 1972." (Emphasis added).

The Merritt affidavit was submitted along with five affidavits by distributors of the Grace wheel, each stating that "[w]e [the distributors] have no particular campaign as such for any of these wheels."

The accuracy of the distributor affidavits was not questioned at trial. With respect to the Merritt affidavit, however, the evidence revealed that Grace had run several magazine advertisements for its Wire Mag wheel. While Mr. Merritt admitted at trial that his affidavit did not accurately reflect all of the Wire Mag advertisements, Grace sought to introduce evidence about the circumstances surrounding the affidavit's preparation, including Mr. Merritt's understanding of the word "major" and his personal misunderstanding of his subordinates' advertising reports. The District Court, however, excluded this evidence, ruling that Mr. Merritt's state of mind and intent were legally irrelevant to

the issue of inequitable conduct before the Patent Office. (Tr. at 644, 791, 808). Nevertheless, having thus excluded evidence highly pertinent to the factual question of *scienter,* the trial judge proceeded to find in its directed verdict ruling, that Mr. Merritt had personally acted in "bad faith" in signing his affidavit, and that such misconduct disabled Grace from enforcing its design patent. (187 U.S.P.Q. at 44). To add insult to injury, the District Court, invoking 35 U.S.C. §285, awarded attorney's fees against Grace on the basis of this finding.

On appeal, the Ninth Circuit declined to affirm the trial judge on the basis of his factual finding that Mr. Merritt had personally engaged in bad-faith conduct—a result which was hardly surprising given the District Court's exclusion of state-of-mind and intent evidence and the well-settled rule that on a directed verdict motion the court is "bound to view the evidence in the light most favorable to [the plaintiff] and to give [him] the benefit of all inferences which the evidence fairly supports, even though contrary inferences might reasonably be drawn." *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 696 (1962). Nor did the Court of Appeals agree with the trial judge that the intent was irrelevant to the inequitable conduct doctrine. Nevertheless, the Ninth Circuit affirmed the judgment below on an unprecedented legal theory which had neither been briefed nor argued in the District Court or on appeal—that even assuming, as a matter of fact, "Mr. Merritt himself harbored no doubts about the truth of his affidavit" (608 F.2d at 1219), Grace was still guilty of misconduct before the

Patent Office *as a matter of law*. The Court of Appeals' *ratio decidendi* was as follows:

> "Merritt admits he erred in the affidavit, but insists it was only because he personally misunderstood his subordinates' reports about the advertising. Grace thus argues that there was a jury question presented on scienter. It is important to remember, however, that the plaintiff and patent holder here is not Merritt, but a corporation, Grace. . . . The evidence was undisputed that *some* agent of Grace had to know about the corporation's advertising for the wheels; thus, Grace must be said to have known it. And even if we assume that Merritt himself harbored no doubts about the truth of his affidavit—a dubious assumption on this record—the corporation, which knew the truth and had ample reason to know of Merritt's actions and statements, must be said as a matter of law to have known that the statements were false." (608 F.2d at 1218-19; emphasis in original).

Solely on this basis, the Ninth Circuit concluded that Grace was chargeable with fraud on the Patent Office "as a matter of law," and affirmed not only the judgment of non-enforceability, but also the award of attorney's fees. (*Id.* at 1219).

REASONS FOR GRANTING THE WRIT.

In essence, the Court of Appeals in this case adopted a theory of strict corporate liability for innocent misstatements to the Patent Office—thus enabling the Court to sidestep the issue of patentability altogether. In a nutshell, the Ninth Circuit held that a corporation is disabled as a matter of law from ever enforcing a presumptively valid patent—even if every one of its employees acted honestly and in good faith—so long as "some agent," somewhere in the corporation, had relevant information which was innocently omitted from the prosecution of the patent application. Put somewhat differently, the Court of Appeals found that a corporation is greater than the sum of its parts; that although no employee of the corporation is guilty of wrongful conduct or even calculated recklessness during the patent application process, the corporation itself can still be guilty of defrauding the Patent Office. We are aware of no other case which has ever premised a finding of inequitable conduct, much less fraud on the Patent Office, on such a theory of strict liability. On the contrary, the Ninth Circuit's holding is in direct conflict with the Eighth Circuit's decision in *Pfizer, Inc. v. International Rectifier Corp.*, 538 F.2d 180 (8th Cir. 1976), *cert. denied*, 429 U.S. 1040 (1977), and with the majority of other Circuits which have uniformly rejected strict liability for innocent or even negligent omissions or misstatements as a basis for denying enforcement of an otherwise valid patent. ***E.g.***, *Schnadig Corp. v. Gaines Manufacturing Co.*, 494 F.2d 383, 393-94 (6th Cir. 1974).

The issue before the Eighth Circuit in *Pfizer* was whether the district court had improperly granted summary judgment for defendant in a patent infringement suit on the ground that the patentee had been guilty of

fraud or inequitable conduct before the Patent Office. The district court in *Pfizer* had imposed upon the patentee an absolute obligation "to disclose any fact that 'may be relevant to an issue of patentability,' " and had held—like the Court below here—that the patentee's "claims of good faith are immaterial and do not create genuine issues of fact." (538 F.2d 185-86).[2]

On appeal, the Eighth Circuit flatly rejected this strict liability concept as "impos[ing] an unworkable standard of conduct upon the patent applicant and expand[ing] the inequitable conduct defense beyond legitimate limits." (538 F.2d at 186). In a passage which highlights the error in the Ninth Circuit's approach below, the Eighth Circuit declared:

> "It would be unwise to attempt to formulate a standard of conduct setting forth all elements of the defense embracing all misconduct before the Patent Office that might justify refusal to enforce a patent. *However, we note that the standard is not one of strict liability for innocent or even negligent omissions or misstatements before the Patent Office.* [Citation omitted]. *Rather, to result in refusal to enforce the patent, the misconduct must be accompanied by some element of wrongfulness, willfulness, or bad faith.* [Citation omitted]. *This requirement of proof has been uniformly applied by a majority of the circuits to claims of both fraud and lesser inequitable conduct.*" (*Id.;* emphasis added).

Accordingly, the Eighth Circuit reversed, holding that because the "issues of intent, good faith and other sub-

[2]In *Pfizer,* as here, the corporate patentee's assertions of good faith rested on the subjective intent of its agents and employees. *See International Rectifier Corp. v. Pfizer, Inc.,* 186 U.S.P.Q. 511, 517 (D. Minn. 1975) ("Pfizer's assertions of good faith belief [are] based on its scientists', patent agents', and attorneys' subjective state of mind . . .").

jective feelings" played "dominant roles" in deciding whether the corporate patentee was guilty of fraud or inequitable conduct, summary judgment was "notoriously inappropriate." (*Id.* at 185).[3]

By holding Grace to a standard of strict liability for innocent misstatements before the Patent Office, the Court of Appeals below dramatically departs from the "uniformly applied" requirement in the majority of other Circuits that a patent cannot be rendered unenforceable for inequitable conduct unless such alleged misconduct is accompanied by "some element of wrongfulness, willfulness or bad faith" — issues which, as *Pfizer* squarely holds, cannot be resolved as a matter of law, but instead entail a factual inquiry into the patentee's "subjective feelings," even where the patentee is a corporation like Grace.[4]

[3]In the petition for certiorari filed in *Pfizer,* it was argued to this Court that the Eighth Circuit had erroneously "require[d] that the subjective intent of the patentee to commit or not to commit a fraud must be determined" (Pet. for Cert. at 11), and that such a requirement "subverts the function of the Patent Office and thwarts the public policy of freeing competition from unwarranted patent monopolies." (*Id.* at 17). Nevertheless, this Court permitted the Eighth Circuit's opinion to stand.

[4]While paying lip service to the element of intent, the Court below concluded that Grace had committed fraud *as a matter of law* even though no employee of the corporation had acted in bad faith, and, indeed, even though Mr. Merritt himself was presumed to have "harbored no doubts about the truth of his affidavit. . . ." (608 F.2d at 1219). The Ninth Circuit sought to justify this harsh result by invoking the principles of imputed knowledge set forth in *Restatement (Second) of Agency* §§256, 272. Yet, conspicuously absent from the Court's analysis was any reference to *Restatement (Second) of Agency* §275, Comment b, which makes it crystal clear that imputed knowledge cannot give rise to corporate liability when intent is an element of the alleged offense. *Accord, Woodmont, Inc. v. Daniels,* 274 F.2d 132, 136 (10th Cir. 1959). Equally misplaced was the Ninth Circuit's reliance on *Acme Precision Products v. American Alloys Corp.,* 422 F.2d 1395 (8th Cir. 1970), since there patent fraud was imputed to the corporation only after a finding that a key corporate officer possessed *both* knowledge of the true facts *and* knowledge of the corporation's activities with respect to the allegedly erroneous Patent Office submission.

Not only is the Ninth Circuit's opinion in direct conflict with the law of other Circuits, but it is at war with the Patent Office's own regulations concerning the duty to disclose in patent prosecutions. Thus, 37 C.F.R. §1.56(a) imposes a duty to disclose "information they *are aware* of" upon

> ". . . every . . . individual *who is substantively involved* in the preparation or prosecution of the application and who is associated with the inventor, with the assignee or with anyone to whom there is obligation to assign the application." (Emphasis added).

Further, as the regulation provides:

> "The duty is *commensurate with the degree of involvement* in the preparation or prosecution of the application." (Emphasis added).

Thus, the Patent Office's own regulations require both *individual* knowledge and *individual* involvement in the application process before the duty to disclose comes into play. Accordingly, the Ninth Circuit's holding that mere knowledge by "some" Grace agent—regardless of that agent's involvement in the application process —is alone sufficient to charge Grace with patent fraud "as a matter of law," collides directly with the disclosure standards promulgated by the Patent Office itself.

Finally, the Ninth Circuit's strict liability ruling —if allowed to stand—would have Draconian consequences for virtually every corporation which seeks to obtain and enforce United States patents. For if, as the Ninth Circuit holds, a corporation is chargeable with patent fraud "as a matter of law" for any innocent omission of relevant information which might be lodged somewhere in the company's bowels, then it

would be incumbent upon the corporate patentee to search every nook and cranny of its files in connection with every patent application it files—or else run the risk that an infringer might later discover such an innocent omission and seek to have the patent declared unenforceable on that ground. Such an obligation—to make absolutely certain that there is no other information somewhere within the corporation that might arguably be relevant to the patent application—would not only be burdensome, but virtually impossible to fulfill. Moreover, it would lead patent applicants to inundate the Patent Office with data of only marginal relevance at best. Judge Mansfield, then sitting in the district court, made this very point in rejecting a strict-liability regime in *Xerox Corp. v. Dennison Mfg. Co.*, 322 F. Supp. 963, 968 (S.D.N.Y. 1971):

> "[T]o deny [patent] enforcement as a matter of law merely because of an innocent or good faith non-disclosure would go beyond what is necessary to protect the public against the improvident granting of a monopoly. Such a standard could also have the harmful effect of forcing a patent solicitor to flood the Patent Office in each case with a mass of data of doubtful materiality rather than take the risk that an inventor might later be denied the fruits of his monopoly because of failure to reveal some fact later magnified out of proportion by an infringer seeking to escape the reach of the patent laws by combing the inventor's files under our liberal pretrial discovery procedures and dredging up new found 'facts.' "

Yet, this is precisely the sort of mischief that the ruling below threatens to spawn.

Conclusion.

For all the foregoing reasons, a writ of certiorari should be granted and the decision of the Court of Appeals reversed.

March 21, 1980.

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